IT 02-0047-GIL 10/29/2002 SUBTRACTION MODIFICATIONS – OTHER RULINGS

General Information Letter: Taxpayer is entitled to subtraction of 42.9% of regular depreciation allowed on bonus depreciation assets, even if that subtraction causes taxpayer to be allowed a greater depreciation deduction than would be allowed had no bonus depreciation deduction been taken.

October 29, 2002

Dear:

This is in response to your letter dated October 25, 2002, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In your letter you have stated the following:

Please clarify Form IL-4562 for the following scenario:

Under old federal depreciation rules, taxpayer purchases 40% of total assets purchased in 2001 in the last quarter of the year. This forces depreciation for ALL ASSETS PURCHASED IN 2001 to be calculated using the mid quarter convention. There were 9 assets purchased in 2001, only one of which was in the 4th quarter 2001. Two of the nine assets are subject to the new bonus depreciation rules. Original regular depreciation on the two assets that will fall under bonus depreciation rules was $15,301. The original regular depreciation for the other seven assets was $37,604. Total depreciation originally claimed was $52,905 ($15,301 + $37,604).

The new federal "bonus depreciation" reduces the assets purchased in the fourth quarter to under 40% of the total assets purchased in 2001 because the 30% bonus depreciation reduces the basis. The amended federal return now also recalculates ALL assets purchased in 2001 to calculate half year depreciation. This changes the depreciation expense on ALL ASSETS. Total Bonus Depreciation is $83,512, regular depreciation on the two bonus depreciation assets are now $27,837, and the recalculated regular depreciation on the other seven assets NOT SUBJECT TO BONUS DEPRECIATION RULES is $26,528. Total Depreciation expense now allowed on the federal amended return is $83,512 Bonus Depreciation PLUS $54,365 ($27,837 + $26,528) regular depreciation.

Form IL-4562 only is concerned with the 30% bonus depreciation and current year depreciation for the TWO assets subject to bonus depreciation. It does not address the changed depreciation for the other 7 assets purchased due to the difference from mid quarter convention to half year convention.

When preparing IL-4562, this predicament is creating a greater overall depreciation on the Illinois return.

Step 2: Line 1 total bonus depreciation expense is $83,512. Line 2 and 3 are blank. (This is a corporation and no assets were sold or traded in 2001.) Line 4 is $83,512.

Step 3: Line 5 total depreciation claimed for property the reported bonus depreciation in Step 2, Line 1, is $27,837. Line 6 is blank. Line 7 is $27,837. Line 8 is $11,942 ($27,837 X .429). Line 9 is blank. Line 10 is $11,942.

Total Federal depreciation on the ORIGINAL return is $52,905.
Total Federal depreciation on the AMENDED return is $137,877 ($83,512 + $54,365)

Form IL-4562 adds back $83,512 and then allows an additional deduction for $11,942 generating state depreciation expense of $66,307. ($137,877 - $83,512 + $11,942).

Our understanding of the law was Illinois was allowing regular depreciation without regard to the 30% bonus depreciation. However, using Form IL-4562 a greater depreciation expense is calculated for Illinois Depreciation under these circumstances. Please clarify our understanding and calculation of Form IL-4562 using the above information.

Response

Under Section 203(b)(2)(E-10) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*), a corporation is required to add back to its federal taxable income:

For taxable years 2001 and thereafter, an amount equal to the bonus depreciation deduction (30% of the adjusted basis of the qualified property) taken on the taxpayer's federal income tax return for the taxable year under subsection (k) of Section 168 of the Internal Revenue Code.

Under Section 203(b)(2)(T) of the IITA, a corporation is then allowed to subtract:

For taxable years 2001 and thereafter, for the taxable year in which the bonus depreciation deduction (30% of the adjusted basis of the qualified property) is taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code and for each applicable taxable year thereafter, an amount equal to "x", where:

(1) "y" equals the amount of the depreciation deduction taken for the taxable year on the taxpayer's federal income tax return on property for which the bonus depreciation deduction (30% of the adjusted basis of the qualified property) was taken in any year under subsection (k) of Section 168 of the Internal Revenue Code, but not including the bonus depreciation deduction; and

(2) "x" equals "y" multiplied by 30 and then divided by 70 (or "y" multiplied by 0.429). The aggregate amount deducted under this subparagraph in all taxable years

> for any one piece of property may not exceed the amount of the bonus depreciation deduction (30% of the adjusted basis of the qualified property) taken on that property on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code.

The computations of the adjustments on Form IL-4562 in the situation you describe accurately implement these statutory provisions. There is nothing in the statute that allows or requires the modifications to be such that the taxpayer's base income after making these adjustments is equal to what it would have been had the bonus depreciation deduction never been allowed. Rather, the IITA prescribes that the bonus depreciation must be added back and 42.9% of the regular depreciation allowed on assets for which bonus depreciation was claimed should be subtracted.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax